1955

First National City Bank Monthly Letter
Business and Economic Conditions

New York, November, 1955

General Business Conditions

THE business reports during October have been impressive and reassuring. Industrial activity continues to rise; probably the Federal Reserve Board's index of production, which in September set a new record at 141 (1947-49 = 100), will show a further advance when the October figures are in. Retail trade climbs steadily to new highs, and merchants are stocking up for what promises to be the best Christmas season yet. Despite some further weakening in home building, over-all construction activity has continued at peak levels.

At the beginning of the month the uncertainties created by President Eisenhower's illness, and by the violent reaction of the stock market, were uppermost in all minds. As the month closes it is plain that the shock has been successfully weathered, and that business shows no disposition to take to the storm cellar. The first question was whether business confidence would be weakened and plans for expansion and capital expenditure would be curtailed. It would be hard to find in the October news any evidence whatever that this has happened. On the contrary, announcements of new programs for enlarging and modernizing industrial capacity have been, if anything, more numerous and extensive than in earlier months.

The excellent recovery that the President is making is one reason for the good business news; it not only relieves the world-wide personal anxieties, but assures the effective continuation of the Administration's policies for the remainder of its term, without Constitutional questions. Looking farther ahead, corporate management plainly believes that the influences for market expansion and economic development outweigh political uncertainties. Business decisions are being made in faith that the country is growing in population and purchasing power, and in full awareness of the rapid rate of change and improvement in industrial technology. Out of the immense expenditures for research come new products and new and better ways of making old products. Companies which hope to build for the future, and to keep abreast of competition, must carry out adequate programs of development, modernization, cost cutting and expansion. Research, population growth and aspiration for better things are the dynamic influences in the economy.

The decline in stock prices, while precipitated by the President's illness, is now generally interpreted as an inevitable reaction from a long and almost uninterrupted advance to levels which by the usual measures were on the high side, and which in many cases were discounting company prospects a long way ahead. To the extent that the drop has toned down exuberant optimism and reminded people to guard against the unexpected, it has provided a salutary note of caution and moderation.

CONTENTS

A "High Plateau"

In a speech in New York early in the month, Dr. Arthur F. Burns, chairman of the Council of Economic Advisers, aptly described the economic situation when he said, "In an economy like ours, poised on a high plateau, neither the threat of inflation nor of recession can ever be very distant."

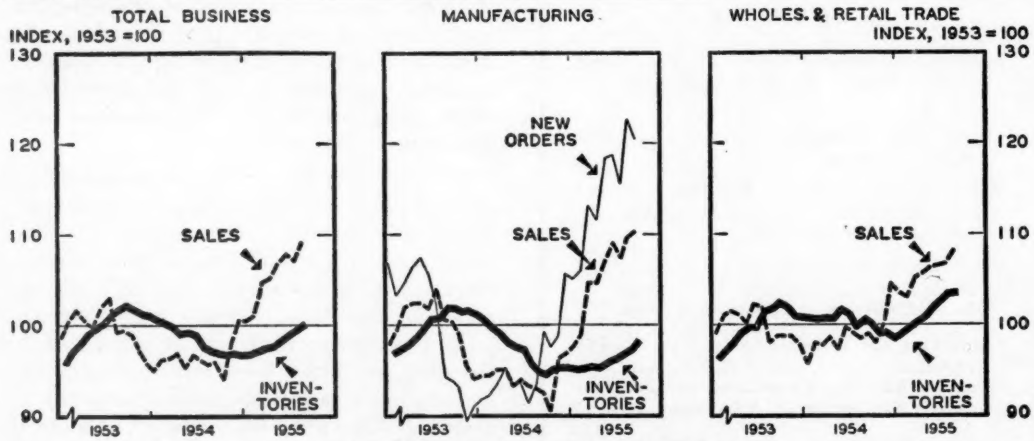
In the third quarter of this year total output of goods and services in the United States reached the record-breaking rate of $392 billion annually, 9 per cent higher than in the corresponding quarter of 1954. More than half of this rise was the result of increased consumer expenditures, backed by confidence in a high and rising level of income and by willingness to incur debt. The remainder came from renewed inventory accumulation and the upsurge of business capital investment, both of which reflect in part the indirect effect of booming retail sales. In the most recent quarter, consumer spending accounted for fully five-sixths of the over-all increase in output from the preceding quarter.

These figures support Dr. Burns' use of the word "high". To that he added the word "plateau", which must be interpreted as signifying that the rate of expansion is slackening and the trend leveling out. The 9 per cent increase in national output in a period of twelve months is between two and three times the long-term average and far above what normally might be expected in a year of peace and relatively stable prices. It would be unreasonable to think that this extraordinary rate of increase can continue. It is bringing the industries not only against the ceiling of effective demand for some particular goods, but also against physical limitations of materials, manpower and capacity. Although there is still room for over-all growth, large gains will be harder to realize hereafter.

Even now current demand for steel, copper, aluminum, and certain other metals exceeds immediately available supplies. Steel mills, which in October produced more than 10 million tons, are already turning out as much as is economically feasible; and while a new round of expansion is in the making the time when new facilities will be adding greatly to the supply is still well in the future. With such a huge outpouring of steel, it can scarcely be said that there is a shortage, yet steel fabricators and users clamor for more both to increase output and to add to working stocks. Demand is strong in other metals, although as the rescinding of recent price increases for zinc and custom smelted copper indicates, it is not a demand at any price.

The inflationary possibilities seen by Dr. Burns, in the quotation given above, lie in the danger of pushing demand beyond the limits of current productive capacity and raising costs and prices; while conversely the deflationary danger is that particular markets may be over-supplied, inventories built up, and a period of readjustment ushered in.

Banking and credit authorities must tread what Dr. Burns characterizes as "the narrow road which separates the swamps of recession on the one side from the cliffs of inflation on the other". They face the problem of avoiding both excessive credit, which would lead to excessive bidding up of prices and borrow demand from the future, and sharply curtailed credit, which might contract demand excessively and make it impossible to finance desirable and economical projects.



Business Inventories, Sales, New Orders, 1953-55
(Seasonally adjusted indexes, 1953 = 100. Latest date shown for manufacturing, September; all others, August.)

Inventory Demand Still Strong

Swings of inventory policy, from accumulation to liquidation and back again, have been powerful influences in the swings of business since the war. During this year the desire to rebuild inventories has been strong in many lines. Some accumulation has taken place, and it has contributed to the general expansion in activity. Beside the rapid gains in sales and production, however, the advance in inventories has been slight. Industrial purchasing agents, in particular, have had difficulty maintaining sufficient raw materials supplies to protect production schedules. Stocks of purchased materials at the end of August were no larger than they were a year earlier before the rise in production got under way. Goods in process necessarily have risen with increased activity, but heavy sales have kept finished goods stocks close to their 1954 low.

On the whole, as indicated in the accompanying chart, manufacturers' sales (seasonally adjusted) have increased one fifth since their low point last fall and new orders are up one fourth in the same period. In sharp contrast, factory stocks showed virtually no change until the spring of 1955 and since then have advanced only 3 per cent. Stocks in September 1955 were $1.7 billion smaller than their all-time peak two years earlier, while sales rose $2.5 billion in the same two-year period. As a result of these divergent movements, the volume of factory inventory per dollar of sales in recent months has been the lowest since early 1951.

At wholesale and retail, the rise in sales has not been as sharp and the rise in inventories has been somewhat greater, but the pattern is much the same.

The inventory figures shown in the charts and cited above pertain to book value of inventories, as compiled by the U.S. Department of Commerce. Preliminary information indicates that the rise in book value was approximately the same in the third quarter of 1955 as in the second quarter. However, nearly half of the third quarter increase in book value of nonfarm inventories is estimated to have represented revaluation of existing stocks, based on higher replacement costs of industrial materials, rather than increased physical volume of inventories. Excluding revaluation, nonfarm inventories rose at a seasonally adjusted annual rate of $2.7 billion in the third quarter, one third slower than the $4.2 billion rate in the second quarter.

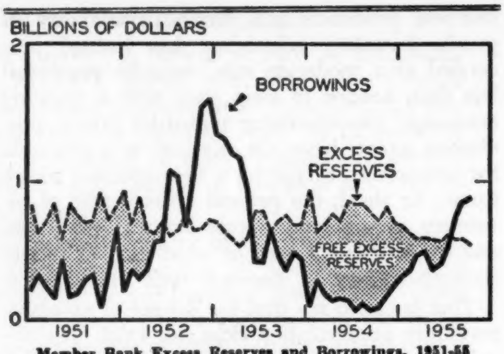
Earlier this year, many observers feared that accelerating inventory accumulation might carry stocks beyond desirable levels and pave the way for a readjustment. Through a combination of business prudence and limited availability of goods, inventory rebuilding has instead proceeded at a moderate rate, actually somewhat less than needed to keep pace with a growing economy. Despite rising industrial prices, purchasing agents have not engaged in a scramble for inventories, except for a few critically scarce items. In short, the present orderly rate of inventory accumulation poses no real problems, and the continuing need to rebuild stocks should strengthen over-all demand well into 1956.

That is not to say that the danger of excessive inventory accumulation does not exist. Historically, business has tended to overshoot the mark in building inventories more often than not, and the cycle of inventory adjustment and replenishment has been an outstanding feature of business fluctuations. The point is that excesses requiring correction have not yet appeared in the inventory situation; similarly prices, credit, the stock market, and other potential trouble spots in the economy are not running out of control. When excesses start to appear, it will be the warning signal that adjustment is at hand. How long the expansion continues depends largely on how fast we try to go.

Credit Under Restraint

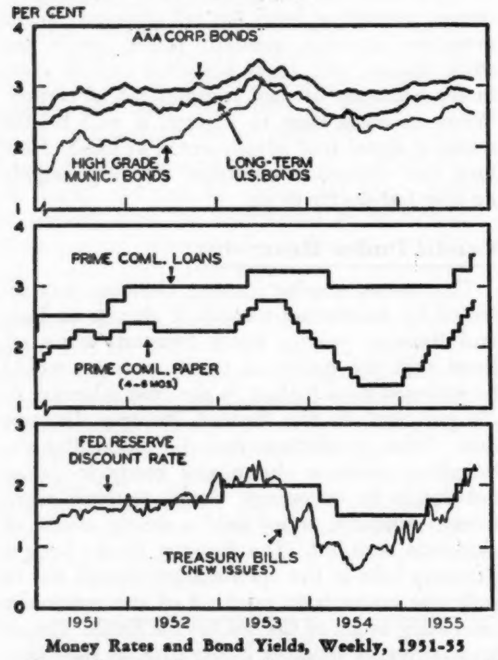
The money market during October was affected by fluctuating rumors of change in Federal Reserve policy. Some forecasts were offered that the policy of credit restraint would be stiffened by a further ¼ per cent advance, to 2½ per cent, in the Federal Reserve discount rate. Other predictions had the authorities anticipating business slump and ready to pump out funds to encourage banks to lend more freely. Actually, policy held a steady course of moderate restraint. The Reserve Banks bought Treasury bills in the open market though not in sufficient amounts to meet all of the seasonally increasing needs of the market for funds. Hence borrowings by member banks rose, as they normally do in the fourth quarter of the year, the daily average moving up from $850 million in September to near $900 million in October.

Yields on new issues of 91-day Treasury bills during October ranged between 2.21 and 2.33 per cent, extending the rise since June to more than ¾ per cent and the increase since October, 1954 to 1¼ per cent. Prime 4-6 months' commercial paper rose ¼ per cent further to 2¾ per cent, making a rise of ¾ per cent since June and of 1⅜ per cent since December. The Treasury paid 2¼ per cent on an offering, October 11, of $2¾ billion tax anticipation certificates due next June 22. An offering in July of "TACs" due in March



Member Bank Excess Reserves and Borrowings, 1951-55
(Monthly averages of daily figures)

paid 1⅞ per cent. While heavily oversubscribed, the new June "TACs" failed to hold a par level in subsequent market trading.



Money Rates and Bond Yields, Weekly, 1951-55

The edging advance of open market rates, in combination with loan demands beyond available resources and losses involved in selling bonds, led principal New York banks on October 14 to raise their prime commercial loan rate from 3¼ to 3½ per cent. The action was quickly followed by leading banks throughout the country. The following table compares the short-term money rate structure in October with a month ago and June, 1953.

Short-Term Money Rate Structure

	June '53	Sept. '55	Oct. '55
Prime Commercial Loan Rate	3.25%	3.25%	3.50%
Prime 4-6 mos. Commercial Paper	2.75	2.50	2.75
Discount Rate	2.00	2.25	2.25
90-day Bankers Acceptances	1.88	2.18	2.18
Treas. Bills, avg. yield on new issues	2.23	2.09	2.26

In the face of rising short-term rates, large new offerings, and continuing bank sales, the bond market showed a firm tone. Demand for bonds was helped by feelings that credit policy might be eased next year in anticipation of the national election. The Treasury 40-year 3s rose to 100½, up 2¼ points from the low mark of 98¼ touched in early August.

Workings of Policy

That credit restraint is working is evidenced in the decline of nonfarm housing starts to a level in September equivalent to 1,230,000 a year. This makes the 1,400,000 annual rate touched last winter and spring look like what it was, a bulge inconsistent with comparative stability in building costs. Indications are that nonfarm housing starts this year will run about 1,300,000 compared to 1,220,000 in 1954.

Effectiveness of credit restraint is also indicated by the fact that the volume of business loans of weekly reporting member banks (disregarding an increase due to reclassification) rose no more than 2.5 per cent during the seven weeks ended October 19. This is a period of the year when crop movements and autumn trade expansion typically produce the heaviest expansion in loans to business. The average increase for the corresponding periods of 1948-54 was 4.3 per cent. While refinancings of bank borrowings in the bond market explain some of this difference, the moderation of the rise this year also reflects the fact that loan officers are screening applications for credit more closely.

The restraint of bank loan volume is not explained by any weakening of demand. As a matter of fact, never in the past twenty years have banks had so many people coming in and wanting to borrow money. The tightness which many banks feel is related not only to Federal Reserve credit policy, reluctance to take losses on bonds, and dislike for borrowings from the Federal Reserve. It is related also to the size of their outstanding loans, their commitments to finance home-building and capital programs, and their responsibilities to meet drawings by regular customers on established lines of credit. Marginal borrowers shop around in search of banks with money to lend and frequently are disappointed. It is well that this is so. If everyone could readily get all the money he wanted we would have uncontrolled inflation on our hands.

The Federal Reserve authorities have in force an effective restraint on credit supply — a degree of restraint they consider adequate in the situation. While the discount rate and some other short-term rates are higher than in 1953, the conditions in the market are not at all compar-

able. In 1953, although the discount rate was 2 per cent against 2¼ per cent now, banks were discouraged from borrowing to relieve pressure. Collapsing bond prices closed the other available avenue to meet loan requirements. Fears spread among lenders and borrowers that they would not be able to handle their commitments.

It is better to have a discount window at which banks can borrow at some price than a discount window posting a low rate at which money cannot be borrowed. Banks now can meet commitments without feeling pressed to sell bonds at any price that can be obtained. When the discount window is closed, bank lending power has rigid limits, as was the case before the Federal Reserve Banks were established to create an elastic currency.

The Federal Reserve System, set up on a principle of elastic response to seasonal and cyclical pulsations of credit demand, gives range to credit expansion when people are inclined freely to borrow and spend. The problem is to apply brakes without locking them. This, clearly, is what the authorities are attempting to do. The effort appears to be meeting with success.

Third Quarter Corporate Earnings

Corporate reports issued during the past month show third quarter sales and earnings generally continuing at near-record levels, with many companies exceeding their former highs reached in 1950 following the outbreak of the Korean war. The widespread gains by individual companies reflect the background of general economic recovery plus long-term growth that have brought new peaks to numerous over-all measures of national prosperity.

Our tabulation of the reports published to date by 749 companies gives a combined net income of approximately $2.6 billion after taxes in the third quarter, a decrease of 5 per cent from the preceding quarter but a jump of 33 per cent from the third quarter of 1954. For the first nine months the net income totaled $7.7 billion, an increase of 31 per cent over the same period of '54. Four out of five reporting companies registered gains over last year in both the third quarter and nine months.

An accompanying summary gives the figures by major industry groups. These companies which promptly make public their financial statements are representative for the most part of the country's larger organizations, rather than small business, and together comprise a substantial segment of total corporate activity.

The improvement in dollar earnings reflects largely the lowering of unit costs resulting from operations at virtually full capacity. It reflects also the increased efficiency and lowered costs brought about by the extensive outlays on modernized plant and equipment. Because of the continued heavy scale at which new capital investment is being poured into American business this year, the net income in dollars has risen considerably faster than the rate of return represented on the growing capital investment.

Enter the $1 Billion Earnings Corporation

New and striking evidence of the growth of American industry appears in the General Mo-

NET INCOME OF LEADING CORPORATIONS FOR THE THIRD QUARTER AND FIRST NINE MONTHS

(In Thousands of Dollars)

No. of Cos.	Industry Groups	Third Quarter 1954	Third Quarter 1955	Per Cent Change†	Nine Months 1954	Nine Months 1955	Per Cent Change†
29	Food products	$36,983	$40,838	+10	$116,451	$118,236	+ 2
10	Beverages	9,128	11,052	+21	22,218	26,623	+20
11	Tobacco products	26,743	30,328	+13	71,796	79,287	+10
26	Textiles and apparel	10,934	20,346	+86	36,678	68,893	+88
26	Paper and allied products	26,311	34,803	+32	84,459	102,529	+21
7	Tires, rubber products	7,082	6,954	− 2	25,144	31,626	+26
34	Chemical products	153,388	225,886	+47	488,009	652,027	+34
20	Drugs, soap, cosmetics	49,487	56,557	+14	126,538	143,439	+13
31	Petroleum producing and refining	434,490	527,477	+21	1,340,464	1,537,411	+15
40	Cement, glass, and stone	68,586	87,354	+27	176,681	245,586	+39
36	Iron and steel	127,521	261,543	†	410,501	759,116	+85
19	Building, heating, plumbing equipment	17,426	19,465	+12	48,202	53,108	+10
21	Electrical equip., radio and television	76,194	73,736	− 3	251,508	246,546	− 2
36	Machinery	28,445	34,596	+22	89,422	98,637	+10
7	Office equipment	16,760	20,518	+22	47,896	54,824	+14
5	Automobiles and trucks	161,997	255,200	+58	592,524	922,561	+56
27	Automobile parts	14,511	24,586	+69	54,818	94,468	+72
14	Railway equipment	9,498	13,326	+40	35,684	38,263	+ 7
72	Miscellaneous metal products	96,851	123,374	+27	262,773	343,389	+31
45	Miscellaneous manufacturing	49,666	73,552	+48	146,848	210,048	+43
516	Total manufacturing	1,422,001	1,941,492	+37	4,428,609	5,826,617	+32
26	Mining and quarrying	26,015	34,354	+32	70,103	100,669	+44
27	Trade (retail and wholesale)	18,702	19,898	+ 6	48,803	51,739	+ 6
17	Service and amusement industries	9,270	13,230	+43	26,419	34,303	+30
47	Railroads	158,755	212,000	+34	371,268	586,293	+58
77	Electric power, gas, etc.	141,200	157,694	+12	483,149	538,907	+12
39	Telephone and telegraph	146,452	175,357	+20	423,876	513,320	+21
749	Total	$1,922,395	$2,554,025	+33	$5,852,227	$7,651,848	+31

† Increases or decreases of over 100% not computed.

tors report showing earnings for the nine months of $913 million, thus pointing towards a total for the full year in excess of $1 billion. While billion dollar corporations, as measured by sales or assets, are not new, this will be the first time that any corporation in the United States or any other country has entered the billion dollar class from the standpoint of net earnings.

The earnings figures are, of course, only part of the story. In building this net income, the company produced and sold during the nine months 3,600,000 cars and trucks, plus other products, to a total of $9,544 million. It gave employment to an average of 621,958 men and women to whom it paid salaries and wages amounting to $2,321 million. It paid or set aside for income taxes alone $1,063 million. The company is owned by over 510,000 registered shareholders and has 275,140,965 shares of common stock outstanding, giving effect to the 3-for-1 split as of September 30.

Characteristic of the shifts taking place in the economy at large is the showing of the report that the record volume of business turned out by this major industrial enterprise during the period was realized in spite of a 30 per cent decline in billings on defense contracts, which account for only 8 per cent of total sales against 15 per cent last year. Numerous other leading industrial companies report a similar experience this year, where a curtailment of shipments on government orders has been more than offset by increased civilian business.

Trends in Manufacturing

Manufacturing companies, which make up over two-thirds of the total number in our tabulation, had an increase of 32 per cent in combined net income for the nine months. Industries realizing sharp increases include steel, automobiles and parts, textiles, chemicals, and cement-glass-stone products.

In several major industry groups, however, there were sizable numbers of companies which experienced a profit squeeze. The downturns were explained in some cases as due to a falling off in sales billed, caused by such factors as growing competition, slumps in market demand, strikes, or cutbacks in government defense orders. In other cases they were caused by advances in labor or raw material costs which were not or could not be passed along in selling prices fast enough or far enough to compensate.

For the 516 manufacturing companies that have thus far reported, the changes in disposition of receipts, partly estimated, are given in the following table:

Sales and Net Income of 516 Manufacturing Corporations in the First Nine Months

(In Millions of Dollars)

	1954	1955	Change Amount	Change %
Receipts from sales, etc.	$63,222	$72,688	+$9,466	+15
Total costs, except taxes	54,551	61,044	+ 6,493	+12
Balance before taxes	8,671	11,644	+ 2,973	+34
Federal income taxes	4,242	5,817	+ 1,575	+37
Net income after taxes	4,429	5,827	+ 1,398	+32
Taxes to balance before taxes	49%	50%		
Net income per sales dollar	7.0¢	8.0¢		

Six out of seven reporting manufacturers achieved an increase in sales billed, the combined total of which expanded 15 per cent. Earnings before taxes were up 34 per cent. Federal income tax liability accruals were stepped up by 37 per cent and on the average absorbed 50 per cent of pre-tax earnings.

Executives of many companies have, on the basis of the actual operating figures for the first nine months and projections for the fourth quarter, already given out official estimates showing gross and net income at new all-time highs for the full year 1955. The sharp percentage gains in earnings by business during the first three quarters, however, may not be maintained for the full year, since the comparisons with 1954 will be affected by the rebound that occurred in the final quarter last year.

In the nonmanufacturing lines given in the summary, the railroads substantially bettered their net income in the first nine months, due largely to the recovery in freight traffic and revenues, passenger revenues showing a further decline. Electric, gas, and telephone utility systems are in general continuing their steady growth in operating revenues and net income. A majority of the reporting companies in the mining and service industries also had increases.

Dividend payments publicly reported by corporations, as tabulated by the U.S. Department of Commerce and now available covering the first eight months, indicate an increase of 8 per cent in the dollar total over the same period last year. Trade dividends were up 3 per cent, electric and gas utilities 4, manufacturing and railroads 7, mining and communications 10, finance 12, and "all other" 14 per cent.

Prosperity Problems Abroad

A year ago Western Europe appeared to be enjoying most of the advantages of an economic boom with few, if any, of the usual drawbacks — as *New York Times* correspondent Michael L. Hoffman put it twelve months ago, "a sort of boom without tears".

Year-end reviews were predominantly cheerful, despite an occasional note of concern over

the zooming stock markets, multiplying wage demands, and the inflationary dangers recognized as latent in conditions of full employment and capacity output. Commodity prices were holding remarkably steady, the rise in wage rates was accompanied by substantial increases in productivity, and – apart mainly from Denmark – no serious balance of payments difficulties had cropped out.

During 1955 forebodings of inflationary pressures have turned into reality. After three years of notable progress in real terms, Western Europe's boom is straining the available resources. With labor and materials employed to the limit, governments and central banks are having to apply restrictive measures in order to maintain internal stability and preserve equilibrium in the international exchanges. The situation in Great Britain highlights conditions present in varying degree throughout Europe.

World Bank and Fund Meetings

It was in this atmosphere that the finance ministers and central bank officials of 58 countries gathered in Istanbul in September for the tenth annual meeting of the World Bank and the International Monetary Fund.

How to maintain prosperity, and avoid inflation of wages and prices under conditions of labor shortage, were the problems uppermost in the minds of the delegates present. While the situation did not appear to call for strong measures in most countries, it was recognized that inflation threatened to undo the gains of the past few years toward building confidence in currencies and liberalizing trade. Unlike the earlier postwar period, most important countries are avoiding direct restrictions on import trade and working to restrain inflation at its source – excessive public and private expenditure financed with borrowed money. Many central banks of issue have raised their discount rates, some to the highest levels in twenty years.

In its annual report the Fund noted the further advances that were made in 1954-55 in the freeing of trade and payments. Among the year's most notable achievements were an extension of *de facto* convertibility and a reduction in the use of quantitative import restrictions and also in discriminations enforced against dollar goods. The Fund noted:

> . . . there has been, both in Europe and in the sterling area, an increasing desire to enjoy the competitive advantage of buying in the cheapest market and a weakening of apprehensions that nondiscrimination on a world-wide basis would endanger trade within a smaller area.

In general, lowered import restrictions and greater *de facto* convertibility were made possible by additions to currency reserves of member countries through increased sales abroad. It is encouraging that the reserves, over-all, have been sustained despite the progressive easing in Europe of exchange restrictions and discriminations against imports from the dollar area. The capacity of foreign nations to open their markets more freely to American goods is traceable to their improved competitive position in world markets and to the sustained supply of dollars.

Pound Under Pressure

Were it not for the adverse balance of payments experienced by the United Kingdom since June, 1954, the stage might have been set, at the time of the September meetings of the Fund and Bank, for a move to break the remaining barriers between the sterling and dollar areas, to make sterling freely convertible, and, with it, the major currencies of Europe. This is something for which people have been waiting since the International Monetary Fund was framed eleven years ago. At the Istanbul meetings the general view was that convertibility was a question which would have to be put off until sterling turned the corner. What cues the Chancellor of the Exchequer, Mr. R. A. Butler, would have to give as to the course of British policy were awaited with the keenest interest. Many rumors had been going the rounds at the time of the meetings that sterling would have to be devalued again.

Mr. Butler met rumors of sterling devaluation with a flat assertion that British exchange policy "has been, and will continue to be, the maintenance of exchange parity of 2.80 dollars to the pound, either in existing circumstances or when sterling is convertible". He pointed out how the removal of restrictions has released human energies, increased human freedom, and stimulated competition and initiative. The problem, as he described it, was that the United Kingdom had become "a too buoyant economy", increasing imports excessively and putting pressure on the balance of payments. Describing the present as a "period of consolidation and strengthening on the home front before we make any further moves forward on the trade or the exchange front", and reiterating the aim "to strengthen sterling as a world-wide, international currency", he stated:

> It is not by physical controls that we intend to solve our difficulties, nor shall we go back on our policy of widening trade and moving to a system of freer payments. We shall deal with the disease, rather than the

symptoms, by getting to the heart of the matter – the balance of supply and demand for labor and materials at home. And so our future policy will continue to be on these fundamental lines.

The Chancellor's remarks were heartening to all those who look to freer commercial intercourse among the nations as the means to higher standards of living everywhere. The British Government has shown remarkable tenacity in holding the gains won in the freeing of markets and in applying restraints on credit to check inflation and redress the balance of payments.

In January and February the discount rate of the Bank of England was raised from 3 to 4½ per cent and restrictions on instalment ("hire-purchase") credit were imposed. In July instalment credit terms were tightened and banks were asked to curtail their loan volumes. These moves, while restricting business spending, did not discourage spending by consumers and public bodies. On October 26 a tightened fiscal policy was brought into play. The Chancellor introduced a revised budget, cutting housing subsidies, public works, and capital programs of nationalized industries and raising purchase (sales) taxes by one-fifth and the corporate tax on distributed profits from 22½ to 27½ per cent. These measures were defended by the Chancellor in a nationwide broadcast as necessary to "save the country's position at home and to make us disciplined and responsible so that we can send exports abroad." In the foreign exchange markets the pound strengthened, providing basis for hope of a turn for the better in the British balance of payments.

The Threat of Inflation

As Mr. Butler pointed out at Istanbul, there are signs of inflation elsewhere. He noted that even countries which have had no trouble with their balance of payments – such as Germany, Belgium and the United States – have taken steps to restrict the expansion of credit. These inflationary pressures are attributable to conditions of labor shortage and overemployment where the natural tendency of labor organizations has been to ask higher wages and of business to grant higher wages and pass the increase in cost along to the consumer in higher prices.

The best antidote lies in the adoption of fiscal and monetary policies that check spending of borrowed money and preserve freedom to labor and industry in price and wage setting. This antidote is being applied, here and abroad. Given the leadership and public support to carry forward these remedies, there seems no reason to doubt that the present problems are manageable.

Controlling the Federal Budget

The prospering state of business and the rise in personal incomes now seem likely to generate revenues for the Federal Government this fiscal year beyond the $62.1 billion foreseen in the August budget review. At the same time Administration officials have expressed hopes that outlays can be pared below the $63.8 billion estimate. Since the prospect in August was for a deficit of $1.7 billion in the current fiscal year, it would take no more than $1 billion improvement in revenues and $1 billion curtailment of expenditures to balance the budget – for the first time in five years. This has whetted expectations that tax cuts may come next on the agenda.

The American people, conscious of the unexampled height of taxes in peacetime and noting the progressive cuts that have been given in Canada and Europe, are anxious to have tax reductions. The fact that 1956 will be an election year has led some observers to predict action on taxes in the next session of Congress regardless of the state of finances. Yet to grant unwarrantable tax cuts at the expense of resumed deficit-financing would be to spur price inflation, a process that the present level of taxes was imposed to prevent. Within a balanced budget, tax relief in 1956 must necessarily be of modest dimensions, even if no allowance is made for chiseling down the swollen public debt. Hopes for more substantial tax relief inevitably run up against the basic budget problem – the level of Federal Government spending.

Recognition of this roadblock to major tax relief underlies the renewed attention being given to wastefulness and weaknesses in controlling federal finances. Citizen's groups such as the Committee for Economic Development, assisted by experts in public finance, have attempted to formulate recommendations for budget-making that would give everyone a better idea of what is going on and what are the costs of the diverse government undertakings.

The Commission on Organization of the Executive Branch of the Government, which had more than 350 experts organized in twenty task forces, reached the central conclusion, in the language of its chairman, ex-President Hoover, that –

> A large part of the wasteful methods in the government arise from systems of administration which were efficient enough before the fabulous growth of the Federal Executive Branch by about 14 times the size of 25 years ago.

While some disagreement on the details of Hoover Commission findings and proposals has been inevitable, hardly any competent observer doubts that better organization and management

can save the taxpayer money. The Administration, after shaking down expenditures by $10 billion annually in three years time, is hampered in going further by weaknesses of the machinery for expenditure control.

Now is a good time to take effective action toward better control and management. There is in fact no alternative if taxes are to be cut soundly and substantially.

The Background

Until 1921, when the Budget and Accounting Act set up the Bureau of the Budget, there was no integrated budget for the entire Government. Each department and agency sent its requests for appropriations to Congress without regard to what others were requesting. Although the budgetary process set up in 1921 was adequate for a $5 billion annual expenditure level, it is not adequate to an establishment spending $60 billion a year.

Under the Legislative Reorganization Act of 1939 the Budget Bureau was enlarged and taken into charge by the President. In a similar Act of 1946 Congress unsuccessfully attempted a Legislative budget to bring appropriations and public debt under better control. In 1947 Congress set up the first Hoover Commission with the job of improving government organization and saving money. In July 1953 Congress set up the second Hoover Commission with powers to recommend changes in government policy as well as in organization. The Congress now has before it twenty reports of this second Commission containing innumerable recommendations for savings, organizational improvements, and simplification of operations.

The complexity of the budget has grown with the rise of expenditures. The current budget for fiscal 1956 is a 1,324 page document. An estimated 90,000 full-time federal employees, plus tens of thousands of additional man-years in part-time efforts, are needed to compile the financial facts of the Federal Government.

Preparation and enactment of the budget is a long process, beginning as much as a year before the President submits it to Congress at the opening of the regular session in January. Congress, responsible under the Constitution for seeing that "no money shall be drawn from the Treasury but in consequence of appropriations made by law" tries to complete action on the budget requests before the July 1 beginning of the fiscal year to which they apply, but rarely succeeds.

This massive effort is justified, in the Hoover Commission's words, by the fact that—

> Budgeting is far more important than preparing figures and estimates of proposed expenditures. The budgeting functions are vital to the whole conduct of our Government. In the preparation of the budget lies not only the control of departmental expenditures but the power to insist on efficient methods of management in the spending agencies. And within an effective budgeting system lies the restoration of the full control of the national purse to the Congress.

Uncontrolled Expenditures

The main criticisms of current budget practice are that the Government knows too little about the costs of its activities; that spending programs are not weighed one against the other in Congress for the best use of a tax dollar but are piled one on top of another; that spending decisions are not systematically related to tax legislation and revenue prospects; and that the present system is wide open to "log-rolling" techniques of getting through authorizations for projects beneficial to particular interests. Congressmen serving on appropriations committees have trouble seeing the woods for the trees. Control of spending depends on the discretion of administrators under the leadership of the President exercised through his Bureau of the Budget. Congressional control, in terms of broad policy, is ineffective. A prudent and balanced spending program needs both close Congressional control and a hard-fisted administration.

The Hoover Commission, in its report to the Congress on budgeting and accounting last June, includes twenty-five detailed recommendations for budget reform. It notes how the practice of making lump-sum appropriations, covering major procurement programs which extend over a period of years, has built up huge backlogs of unexpended appropriations, mostly for military procurement. Such accumulations, which reached $78 billion on July 1, 1953, represent commitments of tax revenues for years to come.

As a guard against such build-up in the future the Commission proposes that Congress currently appropriate only enough to cover estimated expenses for one year at a time, rather than total cost of a procurement program over its entire life. This would insure annual Congressional review of long-term programs. Suppliers of items requiring years to construct — airplanes, ships, major public works — could be contractually protected against loss due to Congressional termination or revision of a program.

A policy statement by the Committee for Economic Development, "Control of Federal Government Expenditures", published last January, also wrestled with the problem of carryovers of unspent appropriations. Observing the neces-

sity of committing funds in advance on long-range military programs, the CED simply recommended more careful programming at the time appropriations are made and more critical scrutiny of legislation authorizing new activities.

Both the Hoover Commission and the CED agree that one of the major barriers to effective budget control is the proliferation of government programs in which spending is determined more or less automatically, according to provisions set in the basic Congressional authorizing legislation. Examples are the CCC price supports, many veterans' benefits, federal grants-in-aid to the States for public assistance and highway construction. To check future expansion of such programs the Commission recommends that authorizing legislation "be enacted for a limited term in order to require periodic Congressional review of their usefulness". The CED would require that "committee reports on bills authorizing new activities . . . include estimates and discussion of the future costs that will be incurred."

The real problem is to develop Congressional resistance to spending and more consideration for the overexploited taxpayer. Otherwise the proposed periodic reviews may become no more than forums for special pleaders and pressure groups seeking new and enlarged programs.

Balancing Expenditures and Revenues

One of the troubles is that the budget process in Congress is splintered. As put by the CED:

> Expenditure decisions tend to be made one by one without weighing against one another the competing claims of the various government programs for funds and without adequately considering the burden of the total.

The CED proposes a "Joint Budget Policy Conference" made up of representatives of the Congressional leadership, and majority and minority members of the appropriations, revenue, and economic committees. This Conference would discuss with Budget Bureau officials the major expenditure-revenue problems and report on its conclusions to the Congress before the major revenue and appropriation bills were taken up, securing in this way common consideration and evaluation of the over-all budget problem. Congress had previously tried, under the Legislative Reorganization Act of 1946, a joint budget committee made up of the Ways and Means and Appropriations Committees of the House and the corresponding committees of the Senate. This effort at better coordination failed because the group was too big and had too little time to digest the budget proposals and reach binding decisions.

The CED also recommends that each House of Congress consider appropriations bills closer together in time, so that Congress can visualize the prospective budget as a whole. The logical extension of this proposal, a single omnibus appropriations bill, was tried out in 1950 and discarded. Congressman Clarence Cannon, Chairman of the House Appropriations Committee, still favors the plan, arguing that it made it possible for Congress to "see the budget all at one time, something that has never been done before or since." Another idea is to give the President power to cut out of appropriations bills objectionable items that slip by the overworked appropriations committees.

Treasury Secretary Humphrey and Budget Director Hughes in June advanced a proposal that Congress work on appropriations bills as at present but hold them for final passage until late in June when the revenue outlook has become clearer. Having the whole picture, Congress could then adjust its tentative expenditure decisions as circumstances dictated. As pointed out in the Budget Bureau's August review:

> This plan would keep the Congress advised in each case of the budgetary effect of its actions on appropriation bills and provide for final action on appropriations to be taken in a way so that total appropriations can be considered and related to estimates of total receipts.

Congressman Cannon has testified to the need for relating appropriations to revenue prospects: "You can go down the roll and find many members who never vote for a tax bill but for every appropriation bill. The people must be protected against that sort of statesmanship." Many Congressmen praise economy, he said, "until it comes to voting on a local disbursement."

As a needed counterweight to attitudes such as these there is the healthy skepticism expressed last year by Representative John Taber of New York, for many years the ranking Republican member of the House Appropriations Committee and a leading advocate of government economy: "I never saw a budget that couldn't be cut. That applies to all of them, Republican or Democrat."

Whatever the budget system, the real test of better budget control will be the Congressional attitudes toward big government and extravagant expenditure. Those attitudes are, of course, responsive to the pressures from back home.

Big Government

The simple truth is that the U. S. Government has gotten so big that no one can comprehend its complexity. It spends $64 billion annually, owes directly $280 billion, and has a contingent liability through various government guarantee

and insurance programs estimated by the Hoover Commission at $244 billion. It has 2.2 million civilians plus 3.0 million members of the armed services on its payroll — one out of thirteen in the national labor force. In addition to all other activities the Federal Government engages in more than 100 separate and distinct business operations with some 2500 entities whose operations include, according to the Hoover Commission: "the manufacture of clothing, paint, ice cream and eye glasses; furniture repair; cement mixing; tree and garden nurseries; coffee roasting; air lines; steamship lines; and a railroad."

Although we have big business corporations in the United States that spread their activities into many fields and markets, there is nothing to compare with the far-flung Federal Government establishment. Qualified experts agree that it is out of effective control and suffers unnecessary waste on almost every hand. Yet they have trouble agreeing on what to do. Every plan has its demerits and objections. Budgetary reform, however desirable, fails to reach the heart of the issue.

The real trouble — and the President's illness gives it point — is that the Federal Government establishment has just grown too big for correlated human control. The obvious solution is for the Federal Government to concentrate on the things that must be done on the federal level and leave the rest to the responsibility of the individual, of private enterprise, of State and local government bodies. After all, as E. B. White once wrote, the American theory is that the individual is "a very competent little guy".

Governor Arthur B. Langlie of Washington, pointing out how federal grants threaten the independence of the States, urges the political principle that "the pleasure of spending public moneys should be tied to the pain of raising them":

> The system of evading responsibility and seemingly getting something for nothing naturally whets the appetite of ambitious politicians for glory and of special-interest groups for more of the easy money. Eventually, the system of depending increasingly on central-government support must lead to central-government domination.

President Eisenhower quotes as his own philosophy Lincoln's statement:

> The legitimate object of government is to do for a community of people whatever they need to have done, but cannot do at all, or cannot so well do for themselves in their separate and individual capacities. And in all that the people can individually do as well themselves, government ought not to interfere.

Curtailing Activities

Here and there unnecessary government operations have been shut down and the money saved returned to the taxpayer. In fiscal 1955 a major achievement along this line was the sale of government-owned synthetic rubber plants to private industry, a transaction which returned $392 million. By last June nearly 100 smaller business activities, mostly in the Department of Defense, had been liquidated. Many products and services formerly produced by government are now being obtained more economically from tax-paying private enterprise. At the same time other government programs are being kept under constant scrutiny for ways of saving money.

Whatever the changes involved — complete elimination, economy measures, or program modification — they meet opposition from vested interests of all kinds. Opposition often comes from surprising sources. Reactions to the Administration's efforts to combat mounting farm surpluses by substituting flexible farm price supports for fixed 90 per cent supports provides a striking case in point. As reported in the *New York Times* of September 27 —

> an astonishing angle of the political quarrel over sagging farm income is the source of pressure on the Administration "to do something about it." The major pressure has come from business men, mainly stanch supporters of the Administration. Their clamor has been heard in the White House as well as the Department of Agriculture.
>
> Administration sources label these business men, mostly from small towns in the Midwest farm belt but including some in industrial centers, as conservative and even "conservative die-hards." They are so vocal "they make the farmers look positively silent," a high Administration source commented.

While such reactions are by no means typical, they are not uncommon. We cannot increase government outlays in particular and reduce them in general. As Budget Director Hughes declared in a speech last June:

> If our efforts in reducing budget expenditures are to be successful, they must be based on an unmistakable groundswell of public support for government economies which cannot be mistaken or denied and which will assist both the administration and the Congress in resisting apparently incessant demands for unwise, hasty and extravagant action.

If people want easier taxes they can have them, but they will have to pay the price of forbearing to urge more spending programs on a Federal Government already overburdened with debt and responsibilities. They must learn to see that the money they get from Washington is the money they sent to Washington, less freight charges both ways.

lew Yo

P. OF
NAMA
Panama

NGAPOR
Singapore

UGUAY
Montevide

NEZUELA
Caracas
Esquina
Santa Ca
Mirand
Military Po